

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent)
System Operator Corporation)

Docket No. ER01-1579-000

**REQUEST FOR REHEARING BY THE
CALIFORNIA ELECTRICITY OVERSIGHT BOARD OF THE MAY 16, 2001,
ORDER ACCEPTING IN PART AND REJECTING IN PART
CAISO TARIFF AMENDMENT NO. 38**

Pursuant to Rule 713 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2000), and Section 313 of the Federal Power Act, 16 U.S.C. § 8251, the California Electricity Oversight Board (“Board”) hereby requests rehearing of the Commission’s May 16, 2001 *Order Accepting in Part and Rejecting in Part ISO Tariff Amendment*, 95 FERC ¶ 61,199 (2001) (“Amendment No. 38 Order”).¹ The failure of the Amendment No. 38 Order to suspend or revoke the underscheduling penalty is arbitrary and capricious and not the product of reasoned decision-making.

¹ The Amendment No. 38 Order notes that the Commission “will make a determination regarding whether to suspend the underscheduling penalty in a future order in [the EL01-34-000] proceeding.” This statement does not, and cannot, transform the Amendment No. 38 Order into an interlocutory ruling that defeats the Board’s right to rehearing. The Amendment No. 38 Order expressly rejected suspension of the underscheduling penalty. A latent ability to seek rehearing of some indeterminate future order cannot adequately substitute for the present right to require the Commission to justify its position in this proceeding and thereby trigger the statutory procedures designed to expedite judicial review of Commission action. 16 U.S.C. § 8251. Thus, any attempt by the Commission to rely on Docket No. EL01-34-000 to delay review in this proceeding would raise serious due process concerns.

I.

BACKGROUND

In the Commission's December 15, 2000, Order Directing Remedies for California Wholesale Electric Markets,² the Commission established an underscheduling penalty in an attempt to reduce California's reliance on the real-time imbalance market operated by the California Independent System Operator ("CAISO"). The penalty applies to load scheduled in real-time to the extent that it exceeds 5 percent of total load. The penalty is \$100 per MWh or twice the cost of real time energy, whichever is less.

On February 2, 2001, in Docket No. EL01-34-000, Southern California Edison ("SCE") and Pacific Gas & Electric ("PG&E") filed a request for immediate suspension of the underscheduling penalty. The filing explained that it was impossible for the utilities to expand their forward purchases because of the demise of the California Power Exchange and their own credit problems. Accordingly, SCE and PG&E asserted that the underscheduling penalty cannot provide any incentive to revise their procurement strategy and instead merely increases the financial burden on energy purchases.

On March 20, 2001, the CAISO tendered for filing proposed Amendment No. 38 to the ISO Tariff. Amendment No. 38 sought to modify two aspects of the ISO's existing Tariff. The first modification sought to suspend the underscheduling penalty through May 31, 2000. Similar to the motion filed by the utilities, the CAISO justified its request to suspend the underscheduling penalty on the primary ground that the financial condition of SCE and PG&E precludes their access to forward markets. The Board filed

² *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operation and the California Power Exchange, et al.*, 93 FERC ¶ 61,294 (2000) ("December 15 Order").

comments in support of Amendment No. 38 further noting that the underscheduling penalty was superfluous given the statutory mandate of the California Department of Water Resources (“CDWR”) to procure energy in forward markets.³

In an order issued on April 6, 2001, in response to the filing by SCE and PG&E, the Commission deferred consideration of the request to suspend the underscheduling penalty and directed the CAISO to file a report on current and projected system conditions.⁴ On April 23, 2001, the CAISO filed its report in Docket No. EL01-34-000 (“CAISO Report”). The CAISO Report concluded that the underscheduling penalty could not achieve its intended purpose of encouraging greater forward contracting and scheduling of energy. This conclusion rested on several justifications. First, absent effective market power mitigation measures, suppliers will have little or no incentive to enter into forward contracts at just and reasonable rates. Second, the reality is that anticipated resource deficiencies throughout 2001 will render it difficult to obtain supplies to cover load in all time-frames. Third, the State of California has become the primary creditworthy buyer on behalf of end-use customers.⁵ Thus, the CAISO Report recommends immediate suspension of the underscheduling penalty.

³ Motion to Intervene and Comments by the California Electricity Oversight Board, Docket No. ER01-1579-000 (April 9, 2001). The Board further observed that the underscheduling penalty injects a perverse incentive into the marketplace. Because of the underscheduling penalty, all market participants understand that load arriving in real-time will pay an additional \$100/MWh over the prevailing price and therefore the market participants possess a higher price indifference point in the forward market. Consequently, the underscheduling penalty creates an incentive for sellers to raise offer prices by a significant fraction of what the penalty is expected to be in the forward market in order to extract value from buyers’ penalty aversion. Sellers will not simply give up the opportunity to earn higher prices in the real-time market. Thus, absent price mitigation in real-time, the underscheduling penalty serves to raise forward prices.

⁴ *Southern California Edison Co and Pacific Gas and Electric Co.*, 95 FERC ¶ 61,025 (2001).

⁵ Response of the California Independent System Operator Corporation to the Commission’s April 6, 2001 Order Deferring Action on Request for Suspension of Underscheduling Penalty and Issuing Request for Information, Docket No. EL01-34-000 (April 23, 2001), at pp. 14 – 16.

On May 16, 2001, the Commission issued the Amendment No. 38 Order, rejecting the CAISO's proposal to suspend the underscheduling penalty. The Commission noted that it "will make a determination regarding whether to suspend the underscheduling penalty in a future order in [the EL01-34-000] proceeding."⁶

II.

THE FAILURE TO SUSPEND THE UNDERSCHEDULING PENALTY IS ARBITRARY AND CAPRICIOUS

The failure to eradicate the underscheduling penalty is arbitrary and capricious and not the product of reasonable decisionmaking. Under conditions prevailing in the California wholesale electricity markets, the underscheduling penalty serves only to exacerbate the financial difficulties confronting SCE and PG&E. It cannot effectively serve as an incentive to encourage utilities or CDWR to forward schedule. Thus, to perpetuate the penalty serves only to increase the ultimate cost of energy to California consumers without furthering any beneficial objective.

The Commission itself requested input from the CAISO in the form of the CAISO Report. The conclusion of the CAISO Report is unequivocal – the underscheduling penalty cannot create the desired incentive to encourage greater forward contracting and scheduling of energy. Given its futility, the CAISO Report explicitly recommended suspending the underscheduling penalty through the end of 2001. No evidence has been submitted to challenge or to overrule the CAISO's conclusion. Accordingly, the decision by the Commission to ignore the CAISO Report by refusing to

⁶ Amendment No. 38 Order, slip op., at p. 6.

suspend the underscheduling penalty is without evidentiary support and is arbitrary and capricious.

The Board concurs with the CAISO Report that the underscheduling penalty has failed, and will continue to fail, to exert its intended influence on the market and currently serves only to punish innocent California consumers. Indeed, in the first 163 days of this year (January 1 through June 12, 2001), only on 37 days was there sufficient generation and load scheduled a day ahead to avoid the underscheduling penalty.⁷ In contrast, the underscheduling penalty has increased the potential liability of the financially distressed utilities by approximately \$1 billion through June 12, 2000.⁸

Basic reasons explain the failure of the underscheduling penalty to operate as an effective incentive. Primarily, the decimated creditworthiness, and bankruptcy of PG&E, have all but precluded any possibility of forward scheduling by the utilities. Simply put, the current financial condition of the utilities prevents the penalty from encouraging forward contracting.⁹

Nor has the State of California completely overcome systemic difficulties in procuring an adequate supply of energy in the forward markets.¹⁰ This is true despite the affirmative mandate set forth in California Water Code section 80100 that the CDWR secure power through forward contracts to the maximum extent feasible. Therefore, the underscheduling penalty is redundant of CDWR's statutory mandate and its perpetuation

⁷ See Update on Unscheduled Load Penalties Imposed by the FERC and IOUs Financial Capabilities (June 2001), included as Attachment A hereto, at p. 1.

⁸ *Ibid.*

⁹ *Id.* at p. 6.

¹⁰ *Id.* at p. 6.

can serve no useful purpose other than to injure innocent California consumers and add to the already suffocating debt shouldered by SCE and PG&E.

III. CONCLUSION

The Board, therefore, requests that the Commission grant rehearing to allow suspension of the underscheduling penalty through amendment to the CAISO Tariff. At a minimum, the Commission should immediately act in Docket No. EL01-34-000 to eliminate the underscheduling penalty as a component of California's overall market mitigation plan.

Dated: June 14, 2001

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing document to be served upon each person designated on the official service list compiled by the Secretary for this proceeding on or before June 14, 2001, pursuant to Rule 2010(a) of the Commission's Rules of Practice and Procedure.

Dated at Sacramento, California, this 14th day of June, 2001.

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